

## ANALYSIS OF THE 2009 AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW

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### INTRODUCTION

The Delaware General Assembly undertook an ambitious agenda in 2009 by adopting several amendments to the Delaware General Corporation Law (the “DGCL”). Certain of these amendments enable Delaware corporations to adopt, and to specifically tailor, “proxy access” procedures for contested elections of directors. Most notably, the amendments permit a corporation to adopt a “proxy access” bylaw that would require the corporation to include stockholder nominees for director on the corporation’s proxy materials. The amendments also permit a corporation to adopt a “proxy reimbursement” bylaw that would provide for the reimbursement by the corporation of the expenses a stockholder incurs in soliciting proxies to elect directors. As with statutory amendments adopted in 2006 to facilitate “majority voting” for director elections, Delaware has again taken an enabling approach which permits corporations to adopt such provisions but does not impose a “one size fits all” mandate on all corporations.<sup>2</sup> Thus, whether to adopt, and how to tailor, proxy access and proxy reimbursement bylaws will be up to the stockholders and directors of every Delaware corporation.<sup>3</sup>

The amendments also introduce new provisions that may be of particular interest to directors. One new provision specifies a default rule for when the indemnification and advancement rights of a director, officer, employee or agent of a corporation “vest” under a certificate of incorporation or bylaw provision. Another new provision empowers the Delaware Court of Chancery to remove directors under limited circumstances. The amendments also enact a series of changes to the DGCL that will enable a board of directors to fix two separate record dates for a given stockholder meeting: one date to determine who is entitled to notice of the meeting, and another later date to determine who is entitled to vote at the meeting.

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1. This article supplements prior reports published by Aspen Publishers and its predecessor, Prentice Hall Law & Business, describing amendments to the Delaware General Corporation Law enacted in each of calendar years 1967; 1969; 1970; 1973-74; 1976; 1981; 1983-1988; and 1990-2008. The authors of one or more of the prior reports are: S. Samuel Arsht; Walter K. Stapleton; Lewis S. Black, Jr.; A. Gilchrist Sparks, III; Frederick H. Alexander; Jeffrey R. Wolters; and James D. Honaker.
  2. See Wolters and Honaker, *Analysis of the 2006 Amendments to the Delaware General Corporation Law* (Aspen 2006) (describing amendments to Sections 141(b) and 216 of the DGCL).
  3. Section 109 of the DGCL gives the stockholders statutory power to amend the bylaws. Directors may exercise such power as well, if granted by the certificate of incorporation, which is usually the case.

Finally, the Delaware General Assembly adopted amendments that increase certain filing fees and franchise taxes payable to the Secretary of State of the State of Delaware. Unless otherwise noted, all amendments took effect on August 1, 2009.

## FORMATION

**Access to proxy solicitation materials [§112].**—The 2009 amendments add a new Section 112 to the DGCL. Section 112 expressly permits a corporation to adopt a “proxy access” bylaw – that is, a bylaw that would require the corporation to include stockholder nominees for director in the corporation’s proxy solicitation materials (including its proxy card) if the corporation solicits proxies with respect to an election of directors. Section 112 also specifies that a proxy access bylaw may impose procedures or conditions that must be satisfied before the corporation is required to include a stockholder nominee on the corporation’s proxy solicitation materials, including conditions:

- to require a nominating stockholder to own (beneficially or of record) a minimum amount of stock or hold such stock for a specified duration;<sup>4</sup>
- to require a nominating stockholder to submit specified information concerning the stockholder and his or her nominee (including information on stock ownership and the ownership of options or other rights related to the corporation’s stock);
- to limit the number or proportion of directors nominated by a stockholder based on how many nominees such stockholder is presenting for election or based on whether the stockholder has previously sought to include a nominee on the corporation’s proxy solicitation materials;<sup>5</sup>
- to deny proxy access to a stockholder if the stockholder (or one or more its affiliates, associates or nominees for director) recently acquired, or publicly proposes to acquire, a specified percentage of voting power of the corporation’s stock within a specified time before the election of directors;<sup>6</sup> and
- to require a nominating stockholder to undertake to indemnify the corporation for any loss arising as a result of false or misleading information submitted by that stockholder in connection with a nomination.

Section 112 also provides that an access bylaw can include any other “lawful condition” as a prerequisite to obtaining proxy access. Accordingly, Section 112 offers corporations the flexibility to make proxy access more available or less available to stockholders depending on the unique needs of each corporation.

As noted above, Section 112 is an enabling provision, i.e., a corporation can require proxy access through a bylaw adopted by its stockholders or by the board of directors (if the certificate of incorporation authorizes the board of directors to amend the bylaws).

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4. For example, a bylaw could permit proxy access only for stockholders who hold or own a minimum amount of stock (based on the number of shares owned or based on the market value of shares owned) for a minimum time period. With respect to the minimum stock ownership requirement, the Synopsis accompanying the legislative bill enacting Section 112 notes that “In establishing such a minimum level of stock ownership, the bylaws may define beneficial ownership to take account of ownership of options or other rights in respect of or relating to stock (including rights that derive their value from the market price of the stock).”
  5. For example, a bylaw could permit proxy access only for stockholders who run a “short slate” of nominees for less than a majority of the seats on the board of directors and could bar access to stockholders who included nominees on the corporation’s proxy materials in connection with prior stockholder meetings.
  6. For example, a bylaw could deny proxy access to a stockholder seeking to acquire the corporation.

The new statute does not *require* proxy access, however, and therefore the decision whether, and how much, proxy access to allow for a given corporation would be left to the stockholders and board of the corporation.<sup>7</sup>

**Proxy expense reimbursement [§113].**—The amendments also add a new Section 113 to the DGCL. This section permits a corporation to adopt a bylaw that would provide for the reimbursement by the corporation of the expenses a stockholder incurs in soliciting proxies in connection with an election of directors. Similar to Section 112, Section 113 permits the drafters of a reimbursement bylaw to condition reimbursement on any “lawful condition” and also expressly authorizes certain types of conditions for reimbursement, including:

- conditioning eligibility for reimbursement on the number or proportion of persons nominated by a stockholder seeking reimbursement or on whether that stockholder previously sought reimbursement for similar expenses;
- limitations on the amount of reimbursement, which could be based on the proportion of votes cast in favor of the stockholder’s nominees or on the amount spent by the corporation in its proxy solicitation; and
- limitations concerning director elections by cumulative voting.<sup>8</sup>

Although Section 113, like Section 112, is intended to provide a corporation flexibility in fashioning a proxy reimbursement scheme to suit its needs, Section 113 contains one mandatory provision: a reimbursement bylaw will not apply to a director election if any record date for that election precedes the adoption of the bylaw. Thus, for example, a stockholder seeking to elect directors to the board will not be able to couple its solicitation for director nominees with a new bylaw proposal that would require the corporation to reimburse the stockholder for the election contest that occurred in the same solicitation that resulted in the adoption of the reimbursement bylaw. Rather, the reimbursement bylaw will apply only prospectively, for director elections that occur after the reimbursement bylaw is adopted.

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7. Shortly after the Delaware General Assembly adopted the 2009 amendments, the United States Securities and Exchange Commission (the “SEC”) proposed a new rule that, if adopted, would require certain corporations to include stockholder nominees on the corporation’s proxy solicitation materials if the stockholder satisfies certain eligibility requirements. The SEC also proposed amendments to Rule 14a-8 promulgated under the Securities Exchange Act of 1934 that, if adopted, would enable a stockholder to require certain corporations to include in their proxy materials proposed bylaw amendments that would allow greater proxy access than contemplated by the proposed mandatory access rule. These proposed rules, and their effect on the application of new DGCL Section 112 if they are adopted, are beyond the scope of this article.

8. The adoption of Section 113 followed a 2008 decision from the Supreme Court of Delaware, *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227 (Del. 2008), that addressed the validity of a reimbursement bylaw. The bylaw at issue in *AFSCME* would, if adopted, have required the corporation to reimburse a stockholder for its reasonable proxy expenses if the stockholder ran a short slate proxy contest (i.e., to elect candidates to less than half of the directorships up for election) and succeeded in electing at least one nominee to the board. Answering questions certified to it by the SEC, the court held that (i) the reimbursement bylaw was a proper subject for stockholder action because its purpose and effect were primarily “procedural,” relating to the regulation of the director election process, but (ii) the bylaw would violate Delaware law if adopted because it did not include a provision that would allow the board of directors to deny reimbursement if the board determined that its fiduciary duties required it to do so (i.e., a “fiduciary out” provision). Neither the text of Section 113 nor the Synopsis accompanying the legislative bill enacting Section 113 expressly mentions *AFSCME* or the “fiduciary out” concept articulated by the court in *AFSCME*. For a more detailed discussion of *AFSCME*, see Wolters and Honaker, Analysis of the 2008 Amendments to the Delaware General Corporation Law (Aspen 2008).

As with Section 112, Section 113 is an enabling provision that permits, but does not require, a corporation to adopt a bylaw providing for proxy expense reimbursement.

### DIRECTORS AND OFFICERS

#### **Indemnification of officers, directors, employees and agents; insurance [§145].—**

The amendments also enact an important change to Section 145, the statute governing the payment of indemnification and advancement of expenses for directors, officers, employees and agents who incur losses or expenses in connection with lawsuits brought by reason of their service to the corporation. The amendment adds an additional sentence to Section 145(f), which specifies a default rule for when indemnification and advancement rights that appear in the certificate of incorporation or bylaws vest. Under the new default rule, if an indemnitee takes action, or fails to take action, at a time when the certificate of incorporation or bylaws offer that indemnitee indemnification and/or advancement rights, subsequent amendments to that certificate of incorporation or bylaw provision will not divest the indemnitee of those rights.

The new default rule was adopted in response to the Delaware Court of Chancery's 2008 decision in *Schoon v. Troy Corp.*, 948 A.2d 1157, 1165-66 (Del. Ch. 2008), which suggested that the right to indemnification or advancement under a bylaw does not vest, and therefore can be taken away from an indemnitee, prior to the time a lawsuit is filed against the indemnitee. The new Section 145(f) default rule provides some assurance to an indemnitee that, if he or she is taking actions in his or her corporate capacity at a time when the certificate of incorporation or bylaws provide for indemnification and/or advancement, those rights will not be taken away by future amendments to that provision.

Amended Section 145(f) permits a corporation to opt out of the new default rule, i.e., to permit a certificate of incorporation or bylaw provision to allow the elimination of indemnity or advancement rights even after an act or omission attributed to an indemnitee occurs. However, the opt out will apply only to acts or omissions that occur after the opt out language is adopted in the certificate of incorporation or bylaws.

### MEETINGS, ELECTIONS, VOTING AND NOTICE

**Contested election of directors; proceedings to determine validity [§225].—**The amendments also add a new Section 225(c). This section permits a corporation (or a stockholder who brings a derivative action on behalf of the corporation) to seek an order from the Delaware Court of Chancery to remove directors from the board if, in connection with their duties to the corporation, they are convicted of a felony or a prior judgment on the merits has been entered against them for breach of the duty of loyalty. In such an action, the court has the discretion to decide whether or not to remove a director from office and may order removal only if the court determines that the director did not act in good faith in performing the acts resulting in the conviction or judgment and that judicial removal is necessary to avoid irreparable harm to the corporation.

**Fixing date for determination of stockholders of record [§213].—**Amended Section 213(a) permits a board of directors to fix two separate record dates for a single stockholder meeting: a "notice" record date to determine the stockholders entitled to notice of the meeting and a later "voting" record date to determine the stockholders who are entitled to vote at the meeting. Prior to the amendment, Section 213(a) permitted the

board of directors to fix only a single record date for purposes of determining the stockholders entitled to notice of, and to vote at, a meeting. Amended Section 213(a) enables a board of directors to fix a record date for notice of the meeting well in advance of the meeting (to allow the corporation sufficient time to distribute the notice and any proxy materials to the stockholders) and to fix a second voting record date closer in time to the meeting. By enabling a corporation to fix a voting record date closer in time to the stockholder meeting, the corporation can attempt to decrease the likelihood of a disparity between the stockholders entitled to vote at the meeting (i.e., the holders on the voting record date) and the persons who actually hold stock as of the meeting date. As a practical matter, however, it is unclear whether public companies will be able to use the new, two-record date system, as it remains to be seen how this system will interact with applicable federal law and the depository system in which non-record beneficial owners vote stock held through a broker or other nominee.

Like the pre-amendment version of Section 213(a), amended Section 213(a) requires that the notice record date be not less than 10 nor more than 60 days before the meeting. However, the voting record date may be any date after the notice record date, including the date of the meeting itself. Practitioners should keep one technical issue in mind when advising a corporation on using the two-record date system: under amended Section 213(a), if the board of directors wants to fix a separate voting record date, it must fix that date at the same time it determines the notice record date, otherwise the voting record date will be the same as the notice record date.

In a related conforming change, the last sentence of amended Section 213(a) permits the board of directors to fix separate notice and voting record dates for an adjourned meeting of stockholders. For adjourned meetings, the notice record date must be on or before the voting record date.

A number of technical amendments to the other provisions of the DGCL (which are discussed below) were adopted to conform those provisions to amended Section 213(a). Corporations should carefully review the provisions of their bylaws to conform them to the amendments.

The Synopsis to the legislative bill enacting amended Section 213(a) observes that the amendments are not intended to affect the application of the doctrine expressed in *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437 (Del. 1971). In *Schnell*, the Supreme Court of Delaware articulated a seminal principle of Delaware corporate law: even if the directors of a Delaware corporation are legally permitted to take an action under a provision of the DGCL, a court may nevertheless review (and potentially enjoin or invalidate) that action if the court finds it is inequitable under the circumstances.<sup>9</sup> The Synopsis signals that a board's power to fix two separate record dates is, if challenged, subject to judicial review to determine whether that power has been exercised in a manner that is unfair to the stockholders in specific factual circumstances.

**Meetings of stockholders [§211].**—Amended Section 211(c) implements a change intended to conform this statute to amended Section 213(a). Section 211(c) empowers the Delaware Court of Chancery to order, upon an application of a stockholder or director, that an annual meeting of stockholders be held if the corporation has failed to

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9. *Id.* at 439 (“[I]nequitable action does not become permissible simply because it is legally possible.”).

hold the meeting within 30 days of the date designated for the meeting in the bylaws or, if no date has been designated, within 13 months of the prior annual meeting. Amended Section 211(c) permits the Delaware Court of Chancery to fix separate notice and voting record dates for a court-ordered annual meeting.

**List of stockholders entitled to vote; penalty for refusal to produce; stock ledger [§219].**—Section 219 requires a Delaware corporation to make a stock list available for stockholder inspection for the 10 days before every stockholder meeting. Prior to the amendment, Section 219 required that the stock list made available for inspection include a complete list of the stockholders entitled to vote at the meeting. Because amended Section 213(a) permits a voting record date that is less than 10 days before the meeting, Section 219 was amended to provide that, if the voting record date is less than 10 days before the meeting, then the stock list available for inspection will reflect the stockholders entitled to vote as of the tenth day before the meeting date.

Section 219 also requires that a stock list be made available for inspection at the stockholder meeting. Under amended Section 219, the stock list made available at the meeting must reflect the stockholders who hold stock as of the voting record date (even if the voting record date is within 10 days of the meeting).

**Notice of meetings and adjourned meetings [§222].**—Section 222, the statute governing the notice that a corporation must provide for a stockholder meeting, was also amended to conform to amended Section 213(a).

Section 222(a), which requires a corporation to provide stockholders written notice of the date, time and place of a stockholder meeting, was amended to require that the corporation include the voting record date in the notice of meeting if it is different from the notice record date for the meeting.

Section 222(b), which specifies that the written notice of a stockholder meeting must be provided to stockholders between 10 and 60 days before the meeting, was amended to clarify that such notice must be provided only to the holders of record on the notice record date for a stockholder meeting.

Section 222(c) specifies the notice requirements that apply when a stockholder meeting is adjourned to another time or place. Section 222(c) was amended to clarify that, if the board of directors fixes a new voting record date for determining the stockholders entitled to vote at the re-convened meeting, the board of directors must also fix a new notice record date for the re-convened meeting in accordance with amended Section 213(a).

**Consent of stockholders or members in lieu of meeting [§228].**—Section 228 permits stockholders to take action by written consent in lieu of a stockholder meeting, unless action by written consent is prohibited in the certificate of incorporation. Section 228(e) requires that, when action is taken by less than the unanimous consent of all stockholders, prompt notice of the action taken by written consent must be provided to the non-consenters. Amended Section 228(e) clarifies that such notice must be given to non-consenters who, if the action had been taken at a meeting, would have been entitled to notice of the meeting if the notice record date had been the date that a sufficient number of written consents were delivered to the corporation to take the action set forth in the written consents.



## MERGER, CONSOLIDATION OR CONVERSION

**Appraisal rights [§262].**—The amendments to Section 213(a) also required that conforming changes be made to Section 262, the statute that allows stockholders to seek a judicial determination of the fair value of their stock in connection with certain mergers and consolidations. Section 262(b) denies appraisal rights to the stockholders of a corporation merging or consolidating with another corporation if, among other exemptions, both before and after the merger the stock held by the stockholders is listed on a national securities exchange or held of record by more than 2,000 holders. Amended Section 262(b) clarifies that the date for determining whether the “pre-merger” or “pre-consolidation” stock satisfies either of these requirements is the date of the notice record date for the merger or consolidation.

Section 262(d) requires a corporation that is submitting a merger or consolidation for approval at a stockholder meeting to provide at least 20 days notice of the availability of appraisal rights to the stockholders. Amended Section 262(d) specifies that this notice must be provided to the stockholders of record on the notice record date for the stockholder meeting.

## SALE OF ASSETS, DISSOLUTION AND WINDING UP

**Dissolution generally; procedure [§275].**—Amended Section 275 conforms to the provisions of amended Section 213(a). Section 275 specifies the general procedures necessary to dissolve a corporation. Amended Section 275 specifies that the notice of a stockholder meeting called to approve a corporate dissolution must be sent to only the stockholders of record on the notice record date fixed for such meeting.

## CORPORATION FRANCHISE TAX

**Rates and computation of franchise tax [§503].**—By amending Section 503, the Delaware General Assembly approved several increases in the Delaware corporation franchise tax. The amendments to Section 503 took effect on January 1, 2009. Section 503 provides that a corporation’s franchise tax (other than the tax for regulated investment companies) is the lesser of an amount derived from one of two methods: the “authorized share method,” which calculates the tax based on the number of shares authorized for issuance in the certificate of incorporation, and an “alternative method” which calculates the tax by looking to the corporation’s total issued shares and gross assets to derive an “assumed par value capital” to assess the taxes owed.

Amended Section 503 includes the following rate changes: (i) increases from \$250 to \$350 the amount of tax attributable to the corporation’s assumed “par value capital” for each \$1,000,000, or part thereof, of assumed par value capital; (ii) increases from \$165,000 to \$180,000 the maximum franchise tax payable for a full taxable year if the corporation employs either the “authorized share method” or “alternative method” of tax calculation; (iii) increases from \$75 to \$350 the minimum amount of annual franchise tax for a corporation that employs the “alternative method” of tax calculation; (iv) increases from \$250 to \$350 the alternative minimum amount of annual franchise tax payable by a regulated investment company for each \$1,000,000, or fraction thereof in excess of \$1,000,000, of the average gross assets of the investment company during

the taxable year; and (v) increased from \$75,000 to \$90,000 the maximum annual franchise tax payable by a regulated investment company.<sup>10</sup>

The General Assembly also enacted certain amendments to Sections 372, 391 and 502 to increase the fees payable to file certain documents with the Secretary of State of the State of Delaware.

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10. With respect to (iv) and (v) above, Section 503(h) specifies a different tax regime for “regulated investment companies” as defined by Section 851 of the federal Internal Revenue Code. These companies must pay an annual franchise tax equal to the lesser of (i) the annual tax they would owe under either the “authorized shares method” or “alternative method” or (ii) an annual tax at the rate of \$350 per annum for each \$1,000,000, or fraction thereof in excess of \$1,000,000, of the average gross assets (as defined in Section 503(h)) thereof during the taxable year. However, Section 503(h) also specifies that in no event must a regulated investment company pay an annual franchise tax greater than \$90,000.





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